



INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Members of the City Council
City of Chattanooga, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely-presented component units, each major fund, and the aggregate remaining fund information of the City of Chattanooga, Tennessee (the City), as of and for the year ended June 30, 2016, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Chattanooga Metropolitan Airport Authority and Chattanooga Area Regional Transit Authority, which represent 100 percent of the assets, net position, and revenues of the discretely-presented component units. Additionally, we did not audit the financial statements of EPB, which represent 56 percent, 47 percent, and 85 percent, respectively, of the assets, net position, and operating revenues of the business-type activities. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Chattanooga Metropolitan Airport Authority, Chattanooga Area Regional Transit Authority and EPB is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely-presented component units, each major fund, and the aggregate remaining fund information of the City of Chattanooga, Tennessee as of June 30, 2016, and the respective changes in financial position and, where applicable, cash flows thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages iv through xxii of the Financial Section and the required supplementary information on pages B-1 through B-16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We and other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Chattanooga's basic financial statements. The introductory section, combining and individual nonmajor fund and component unit financial statements, the budgetary comparison schedules included as other supplementary information, financial schedules, statistical tables and schedule of expenditures of federal and state awards, as required by the audit requirements of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements of Federal Awards* (Uniform Guidance) are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining and individual nonmajor fund and component unit financial statements, the budgetary comparison schedules included as other supplementary information, financial schedules, and schedule of expenditures of federal and state awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America by us and other auditors. In our opinion, based on our audit, the procedures performed as described above, and the report of the other auditors, the combining and individual nonmajor fund and component unit financial statements, the budgetary comparison schedules included as other supplementary information, financial schedules, and schedule of expenditures of federal and state awards are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2016, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control over financial reporting and compliance.

Chattanooga, Tennessee
December 19, 2016

Henderson Hutcherson
& McCullough, PLLC

Management's Discussion and Analysis

As management of the City of Chattanooga (the "City"), we provide readers of the City's financial statements with this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2016. We encourage readers to consider the information presented here in conjunction with our Letter of Transmittal beginning on page Intro 3 and the financial statements beginning on page A-1.

Financial Highlights

- Assets and deferred outflow of resources for the primary government exceeded liabilities and deferred inflow of resources by \$1.9 billion (net position), an increase of \$100.0 million, or 5.5 percent, at the close of the fiscal year. Of this amount there is a \$55.4 million deficit unrestricted net position. The deficit in unrestricted net position improved by \$117.1 million largely due to a \$101.5 million increase in Business-Type Activities.
- Net position of governmental activities at June 30, 2016 was \$1.2 billion, an increase of \$30.6 million, or 2.6 percent. Business-type activities reported ending net position of \$718.8 million, an increase of \$69.4 million, or 10.7 percent due to favorable operations trend in all business-type activities.
- Long-term liabilities for the City's primary government increased \$113.7 million or 11.9 percent, during the current fiscal year. Governmental activities long-term liabilities increased \$62.2 million. \$47.2 million in bonds were issued: \$28.2 million to finance new projects and \$19.0 million to refinance \$19.5 million. \$17.2 million in debt was retired in fiscal year 2016. Liabilities for pension and employee accrued leave increased by \$48.2 million and Other Post Employment Benefits (OPEB) decreased by \$3.0 million. Business-type activities long-term liabilities increased \$48.5 million. \$268.2 million in bonds were issued \$49.3 to finance new projects and \$218.9 million to refinance \$239.9 million in existing debt. An additional \$19.2 million in bonds were retired. \$33.8 million in notes were issued for the Interceptor Sewer System. EPB decreased a line of credit \$17.5 million.
- At the end of the current fiscal year, unassigned fund balance for the General Fund is \$65.9 million, an increase of \$10.8 million or 19.6 percent from prior year. This represents 27.3 percent of total General Fund expenditures and transfers out.



Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City of Chattanooga's basic financial statements which consist of three parts: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. This comprehensive financial report also contains supplementary information intended to furnish additional detail to support the basic financial statements themselves.

Government-wide Financial Statements

The first statements presented are government-wide financial statements. They are designed to provide readers with a broad overview of the City's finances in a manner similar to a private-sector business.

There are two government-wide financial statements:

Statement of Net Position - This statement presents information about the City's assets, deferred outflow of resources, liabilities and deferred inflow of resources, with the difference reported as net position. Over time increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

Statement of Activities - This statement presents information showing how the City's net position changed during the most recent fiscal year. All current year revenues and expenses are reported as soon as the underlying event giving rise to the change occurs. Thus revenues and expenses are reported in this statement for items that will only result in cash flows in future fiscal years (e.g., revenue includes uncollected taxes and expenses include earned but unused vacation leave).

The government-wide financial statements reflect three distinct activities:

Governmental Activities - These activities are primarily supported by taxes and intergovernmental revenues. The governmental activities of the City include general government, economic and community development, public safety, public works and transportation, and youth and family development.

Business-type Activities - These activities are supported by user fees and charges for service which are intended to recover all of their costs. Included are electric, sewer, water quality systems, solid waste disposal, as well as communications system. Also included is The Chattanooga Downtown Redevelopment Corporation, a legally separate entity that functions as an enterprise of the City and therefore has been included as an integral part of the primary government.

Component Units - There are two entities that are legally separate and reported separately from the primary government, however the City of Chattanooga is financially accountable for them. These include: The Chattanooga Metropolitan Airport Authority and the Chattanooga Area Regional Transportation Authority (CARTA).

Governmental activities and business-type activities combine to comprise the primary government. The government-wide financial statements begin on page A-1 of this report.



Fund Financial Statements

The fund financial statements provide more detailed information about the most significant funds — not the City as a whole. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific purposes. Some funds are required by State or Federal law or by bond covenants. Other funds are established by the City to help manage money for specific purposes (i.e. economic development) or to show that it is meeting legal responsibilities for how certain monies are used (i.e. grants received from the U.S. Department of Housing and Urban Development or hotel-motel taxes).

All the funds of the City can be divided into three types of funds: (1) governmental funds, (2) proprietary funds, and (3) fiduciary funds.

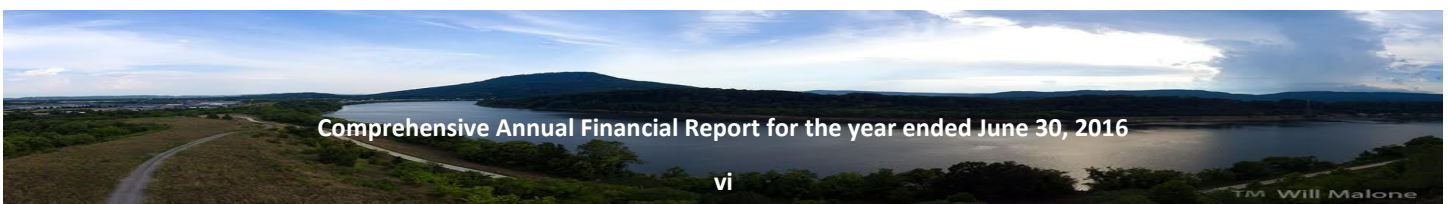
Governmental Funds --These funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However the focus of these funds is on: 1) how cash and other financial assets that can readily be converted to cash were received and used, and 2) what remains at the end of the fiscal year for future spending. This information may be useful in evaluating the City's near-term financing requirements.

Because the focus of the governmental funds statements is narrower than that of the government-wide financial statements, it is useful to compare the information presented between the two. By doing so, readers may better understand the long-term impact of the City's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate the comparison between governmental funds and governmental activities in the government-wide financial statements.

The City maintains a general fund, multiple special revenue funds, a debt service fund, a capital projects fund and one permanent fund as governmental funds. Information is presented separately in the governmental statements for the General Fund and the Capital Projects Fund since both of these are considered major funds. Data for the other funds is combined into a single column with individual fund data for each of these nonmajor governmental funds provided in the other supplementary information section of this report.

The City of Chattanooga adopts an annually appropriated budget for the General Fund, special revenue funds and the debt service fund. Budgetary comparisons are provided for these funds to demonstrate compliance with the budget. The General Fund budgetary comparison is found in the fund statements of this report. Additional details for the General Fund along with budgetary comparisons for special revenue funds and the debt service fund are provided in the other supplementary information section of this report. Since neither the Capital Projects Fund nor the permanent fund adopts an annual budget, they are excluded from budgetary reporting.

Governmental fund financial statements begin on page A-4 of this report.



Proprietary Funds - The City of Chattanooga maintains two types of proprietary funds: (1) enterprise funds and (2) internal service funds.

- **Enterprise funds** are used to report the same functions presented as business-type activities in the government-wide financial statements but provide more detail and additional information, such as cash flows. The Electric Power Board (EPB), Interceptor Sewer System, Water Quality Management, Solid Waste, Tennessee Valley Regional Communications System and Chattanooga Downtown Redevelopment Corporation are considered major funds.
- **Internal service funds** are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City of Chattanooga accounts for fleet maintenance, technology replacement and risk financing (e.g. medical cost and third party liability claims) in the internal service fund. The internal service funds are combined into a single column in the proprietary fund statements. Because these services predominantly benefit governmental rather than business-type functions, they have been included as part of governmental activities in the government-wide financial statements.

Proprietary funds statements begin on page A-9 of this report.

Fiduciary Funds - These funds are used to account for resources held for the benefit of others outside the government. While the City is responsible for ensuring that the assets are used for their intended purposes, we exclude these activities from the government-wide financial statements since these assets cannot be used to finance City operations.

The City of Chattanooga maintains a pension trust fund and an other post-employment benefits (OPEB) trust fund as fiduciary funds to account for resources held on behalf of participants in the City pensions plans and OPEB plan. The accounting used for fiduciary funds is much like that used for proprietary funds.

Fiduciary fund financial statements begin on page A-15 of this report.

Notes to the Financial Statements

The financial statements also include notes that provide additional information that is essential to a full understanding of the government-wide and fund financial statements.

The notes to the financial statements begin on page A-19 of this report.

Supplemental Information

Required supplementary information - in addition to the basic financial statements and accompanying notes, this report also presents *required supplementary information* regarding the City's progress in funding its obligation to provide pension and OPEB benefits to its employees.

Required supplementary information begins on page B-1 of this report.



Other supplementary information - begins on page C-1 and includes:

- Combining statements for nonmajor governmental funds
- Combining statements for discretely presented component units
- A more detailed budget to actual comparison for the General Fund
- Budget to actual comparisons for special revenue funds and the debt service fund

Government-wide Overall Financial Analysis

Net position may serve over time as a useful indicator of the City's financial position. Assets and deferred outflow of resources exceeded liabilities and deferred inflow of resources by \$1.9 billion at the close of the most recent fiscal year, an increase of \$100.0 million, or 5.5 percent, from last year. At the end of the fiscal year, the City of Chattanooga is once again able to report a positive net position for the government as a whole, as well as for its governmental and business-type activities individually.

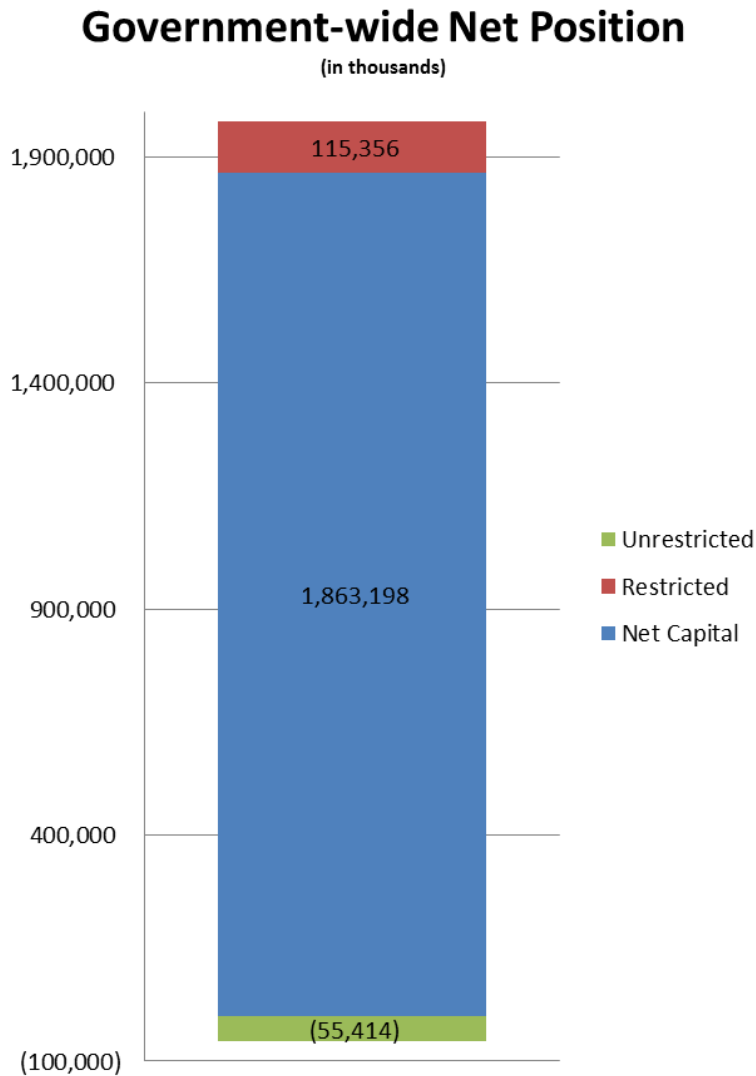
City of Chattanooga's Net Position

(in thousands)

	Governmental Activities		Business-type Activities		Total	
	2016	2015	2016	2015	2016	2015
Current and other assets	\$ 298,558	\$ 260,825	\$ 465,806	\$ 412,194	\$ 764,364	\$ 673,019
Capital assets	1,486,828	1,472,295	1,009,687	964,104	2,496,515	2,436,399
Total assets	1,785,386	1,733,120	1,475,493	1,376,298	3,260,879	3,109,418
Total deferred outflows of resources	66,438	28,443	28,310	11,512	94,748	39,955
Long-term liabilities outstanding	467,549	405,393	598,409	546,840	1,065,958	952,233
Other liabilities	29,012	26,387	183,645	186,587	212,657	212,974
Total liabilities	496,561	431,780	782,054	733,427	1,278,615	1,165,207
Total deferred inflows of resources	150,886	155,982	2,986	5,027	153,872	161,009
Net position:						
Net investment in capital assets	1,272,354	1,275,429	590,844	603,011	1,863,198	1,878,440
Restricted	66,118	47,791	49,238	69,422	115,356	117,213
Unrestricted	(134,095)	(149,419)	78,681	(23,077)	(55,414)	(172,496)
Total net position	\$ 1,204,377	\$ 1,173,801	\$ 718,763	\$ 649,356	\$ 1,923,140	\$ 1,823,157

By far the largest portion of the City's net position, \$1.9 billion, reflects its investment in capital assets (land, buildings, equipment, infrastructure, etc.), less any related outstanding debt that was issued to acquire those assets. While capital assets are used to provide services to citizens, these assets are not available for future spending. It should be noted that although the City reports capital assets net of related debt, the resources needed to repay the debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the City's net position, \$115.4 million, represents resources that are subject to external restrictions on how they may be used. There is a \$55.4 million deficit in unrestricted net position due to recording of unfunded pension liabilities. Please refer to Note 8.



The chart on the next page provides revenue and expense details for Governmental Activities, Business-type Activities and the Primary Government as a whole.

City of Chattanooga's Changes in Net Position

(in thousands)

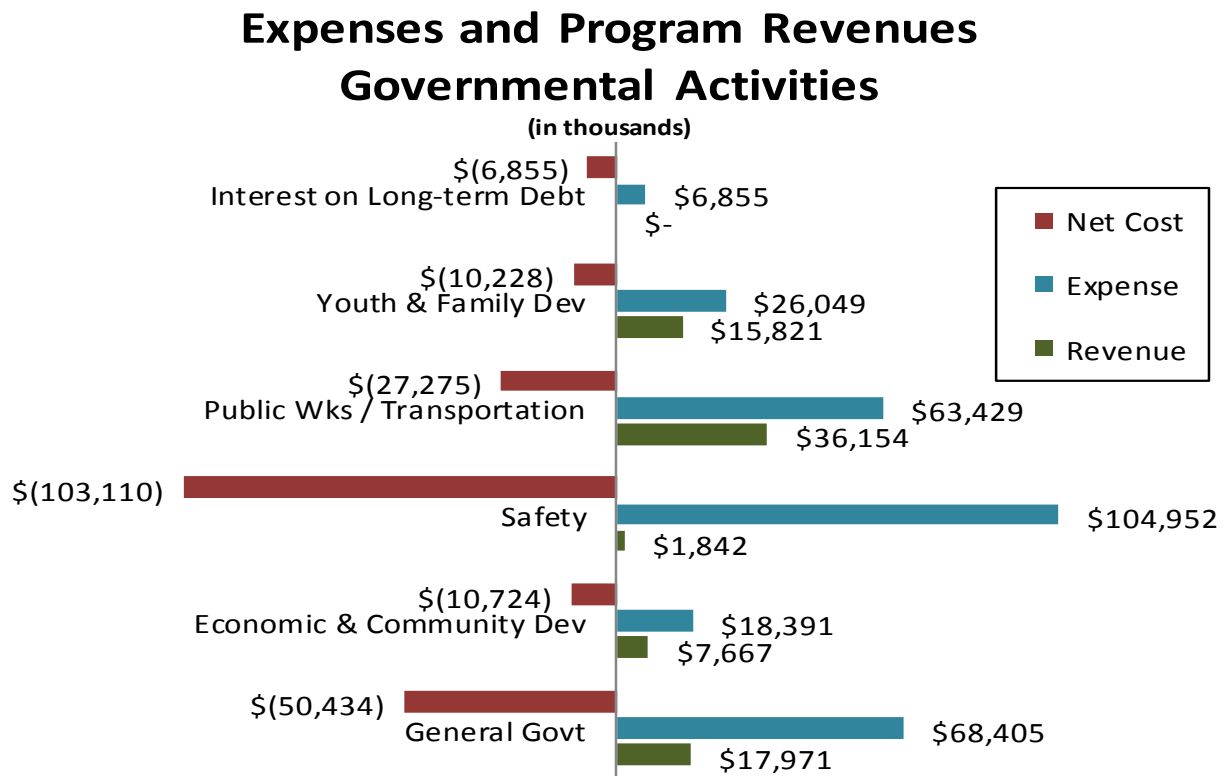
	Governmental Activities		Business-type Activities		Total	
	2016	2015	2016	2015	2016	2015
Revenues						
Program revenues:						
Charges for services	\$ 20,618	\$ 21,898	\$ 801,528	\$ 781,226	\$ 822,146	\$ 803,124
Operating grants	30,519	36,065	-	-	30,519	36,065
Capital grants	28,318	1,557	985	739	29,303	2,296
General revenues:						
Property taxes	130,903	127,520	-	-	130,903	127,520
Other taxes	26,073	23,361	-	-	26,073	23,361
Investment income	1,753	955	1,816	1,186	3,569	2,141
Miscellaneous	836	1,525	-	-	836	1,525
Unrestricted grants and contributions	79,586	75,505	-	-	79,586	75,505
Total revenues	<u>318,606</u>	<u>288,386</u>	<u>804,329</u>	<u>783,151</u>	<u>1,122,935</u>	<u>1,071,537</u>
Expenses						
Governmental activities:						
General government	68,405	68,923	-	-	68,405	68,923
Economic and community development	18,391	25,728	-	-	18,391	25,728
Public safety	104,952	82,129	-	-	104,952	82,129
Public works and transportation	63,429	66,225	-	-	63,429	66,225
Youth and family development	26,049	23,455	-	-	26,049	23,455
Interest on long-term debt	6,855	6,904	-	-	6,855	6,904
Business-type activities:						
Electric utility	-	-	653,115	655,053	653,115	655,053
Sewer	-	-	46,230	48,141	46,230	48,141
Solid waste	-	-	4,146	4,126	4,146	4,126
Water quality	-	-	13,689	13,152	13,689	13,152
Regional communications	-	-	931	-	931	-
Downtown redevelopment	-	-	16,760	16,761	16,760	16,761
Total expenses	<u>288,081</u>	<u>273,364</u>	<u>734,871</u>	<u>737,233</u>	<u>1,022,952</u>	<u>1,010,597</u>
Excess (deficiency) before transfers	30,525	15,022	69,458	45,918	99,983	60,940
Transfers	<u>51</u>	<u>-</u>	<u>(51)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Increase (decrease) in net position	30,576	15,022	69,407	45,918	99,983	60,940
Net position, beginning	<u>1,173,801</u>	<u>1,158,779</u>	<u>649,356</u>	<u>603,438</u>	<u>1,823,157</u>	<u>1,762,217</u>
Net position, ending	<u>\$ 1,204,377</u>	<u>\$ 1,173,801</u>	<u>\$ 718,763</u>	<u>\$ 649,356</u>	<u>\$ 1,923,140</u>	<u>\$ 1,823,157</u>

Governmental Activities

During the current fiscal year, net position of the City's governmental activities increased \$30.6 million from the prior year for an ending balance of \$1.2 billion. Overall revenue increased \$30.3 million or 10.5 percent. \$21.6 million of the increase is from capital grants primarily from donations of streets. County-wide sales tax increased by \$3.8 million or 6.9 percent and state sales increased 0.8 million or 5.9 percent over the prior year and property tax increased by \$3.4 million or 2.7 percent.

Expenses for the current year increased \$14.7 million or 5.4 percent. \$22.8 million or 27.8 percent of the increase is in Public Safety. The increase primarily consists of \$8.5 million in personnel costs and an \$11.7 million pension expense adjustment to pension expense to record the change in pension liability. This is offset by a decrease in Economic and Community Development of \$7.3 million or 28.5 percent. In fiscal year 2015 there was a \$4.4 million project to demolish a housing complex. The City's remaining appropriation to the VW expansion was \$2.7 million less in fiscal year 2016.

The graph below provides the program revenue and expenses for each governmental activity. It also provides the net cost that must be provided from general revenues.



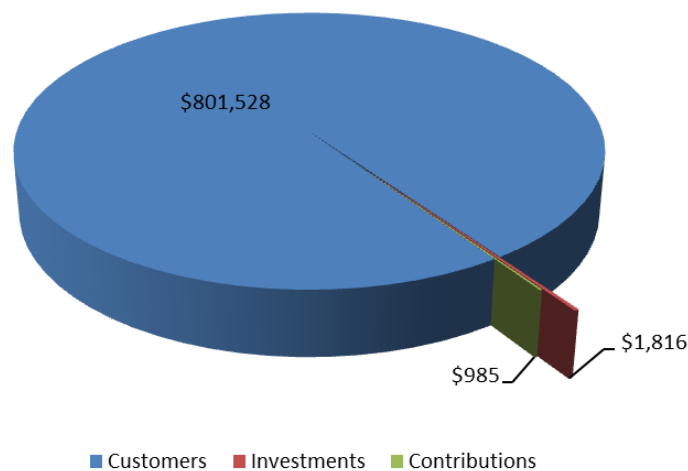
Business-type Activities

During the current year, net position of the business-type activities increased \$69.4 million or 10.7 percent, to \$718.8 million. This net position is dedicated solely to finance the continuing operations of the electric, sewer, water quality systems, solid waste disposal, regional communications systems and downtown redevelopment operations.

Revenues for the City's business-type activities were \$804.3 million for the year just completed; this is a \$21.2 million or 2.7 percent increase. Expenses decreased \$2.4 million or 0.3 percent resulting in total expense of \$734.9 million for the year. Please see Enterprise Fund detail for additional information.

As you can see from the following graph, the major source of revenue for business-type activities is customer charges.

Revenues by Source Business-type Activities
(in thousands)



The following table provides a summary for each business-type activity. Each is discussed in more detail with the proprietary fund information.

Expenses and Revenues - Business-type Activities
(in thousands)

	Electric	Sewer	Solid Waste	Water Quality	Regional Communication System	Downtown Revelopment	Total
Expenses	\$ 653,115	\$ 46,230	\$ 4,146	\$ 13,689	\$ 931	\$ 16,759	\$ 734,870
Revenues	684,925	70,770	7,002	19,626	1,307	18,883	802,513
Change in net position	\$ 31,810	\$ 24,540	\$ 2,856	\$ 5,937	\$ 376	\$ 2,124	\$ 67,643

Financial Analysis of the City's Funds

As noted earlier, the City of Chattanooga uses fund accounting to help control and manage money for particular purposes or to demonstrate compliance with legal requirements. The following provides a more detailed analysis of the City's funds.

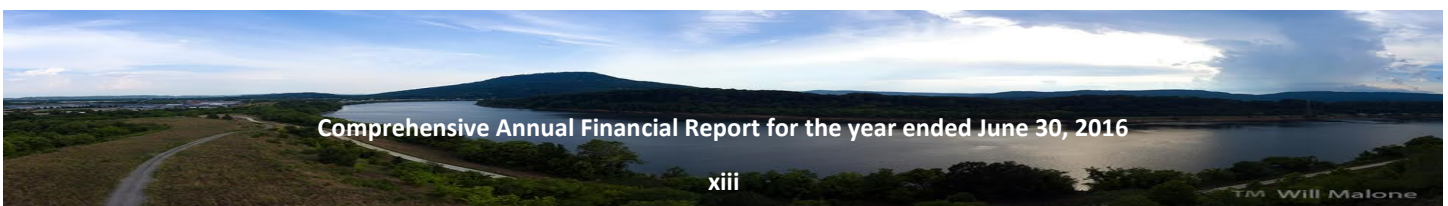
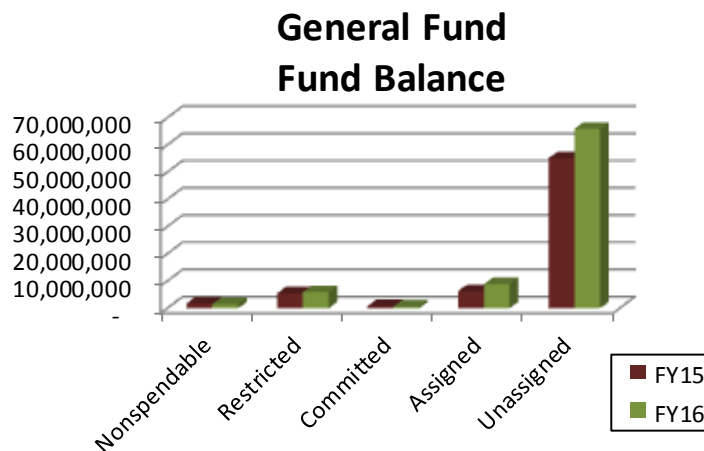
Governmental Funds

Governmental funds focus on the near-term flow of resources and balance of spendable resources. This information is useful in assessing the City's financing requirements. In particular, unassigned fund balance may serve as a useful measure of the City's resources available for discretionary use since it represents the portion of fund balance which has not been limited for a specific purpose.

The City's governmental funds reported a combined fund balance of \$169.2 million at the end of the fiscal year. Of this amount 39.0 percent or \$65.9 million, is available for spending at the City's discretion (unassigned fund balance). Total fund balance is made up of the following:

- \$6.3 million is in non-spendable form such as inventories and notes receivable.
- \$79.7 million is restricted for particular purposes due to restrictions placed by grants, bond covenants, other governments or by City ordinance.
- \$7.1 million is committed for specific purposes based on City resolutions.
- \$10.1 million is assigned for particular purposes such as under control of boards or designated purpose by management.
- \$65.9 million is unassigned for General Fund discretionary use.

General Fund: This is the chief operating fund of the City. Total fund balance of the General Fund increased by 19.3 percent or \$13.4 million to \$82.8 million during the fiscal year. Unassigned fund balance increased \$10.8 million or 19.6 percent to \$65.9 million. During fiscal year 2015 there was a \$26.5 million planned use of operational dollars and fund balance for pay-as-you-go capital and economic development incentives.



As a measure of the General Fund's liquidity, it may be useful to compare both unassigned fund balance and total fund balance to General Fund expenditures. Unassigned fund balance represents approximately 27.3 percent of total General Fund expenditures and transfers out, while total fund balance represents 34.3 percent.

Revenues: Total revenues increased \$8.8 million or 3.6 percent, from the prior year. All major revenue sources are discussed as follows.

- Tax revenue is \$3.4 million or 2.3 percent higher than in the prior year. During the current fiscal year, property tax, along with payments in lieu of tax (PILOT), increased \$2.5 million or 2.0 percent over last year with \$1.6 million of the growth in property taxes and \$0.9 million PILOT revenue. Liquor and beer taxes are up \$438,000 or 5.4 percent while gross receipts increased \$706,000 or 14.4 percent. Franchise fees are \$312,000 or 6.6 percent lower than prior year. The gas company's franchise fee was \$407,000 or 19.4 percent less due to a mild winter.
- Licenses and permits are up \$854,000 or 14.3 percent. Building related permits increased \$639,000 or 23.5 percent highlighting the health of the local economy. In 2015 a new revenue source was an economic development fee imposed as part of all new PILOT agreements; this fee increased 18.3 percent to \$148,000 in 2016.
- Intergovernmental revenues increased \$4.6 million or 5.8 percent over the prior year. This is primarily resulting from a \$3.9 million or 7.2 percent increase in local option sales tax, another indicator of the health of the local economy. State shared sales tax is up \$866,000 or 6.9 percent. These increases are offset by a \$390,000 or 100.0 percent decrease in the congestion mitigation grant from the State of Tennessee as the final phase of the project was completed in 2015.
- Charges for services decreased 19.9 percent or \$1.0 million. This decrease is primarily due to loss of \$931,000 resulting from council decision to contract the management of the civic facilities to the Tivoli and Memorial Foundation.
- Fines, forfeitures and penalties decreased \$117,000 or 4.4 percent primarily due to decrease from automated traffic enforcement. A new state law is being phased in which limits this type of enforcement.
- Investment income increased \$1.0 million or 111.2 percent resulting from the availability of additional proceeds from a bond sale, more timely request for grant reimbursements and decrease in cash flow funding for economic development projects. The city has also placed greater emphasis on ensuring all idle funds are invested at the maximum rate of return allowed by law.
- Major changes in the \$115,500 or 1.7 percent increase in miscellaneous income include a \$104,000 increase of contributions for programs such as Bike Chattanooga.



Expenditures: Total expenditures increased \$1.2 million or 0.6 percent, from the previous year. Major changes during fiscal year 2016 are discussed below:

- Employee Compensation increased by \$2.1 million or 2.4 percent. Civilian personnel earning less than \$50,000 received a lump sum increase of \$750 while all other civilians received a 1.5 percent increase in base pay. Sworn personnel increases were provided based on a career ladder program. The largest increase in personnel costs was a \$1.7 million or 16.6 percent increase in Fire and Police Pension contributions. General Pensions contribution amounts were flat.
- Operations costs decreased by 1.1 million or 0.9 percent. During the prior year, the first of six \$1.96 million installments were made to Hamilton County Tennessee based on a settlement for past mixed-drink taxes. The second installment for fiscal year 2016 is shown as a transfer to the Debt Service fund .
- Transfers out included an additional \$30.6 million for capital projects.

Capital Projects Fund -- This fund focuses on project-to-date costs for many projects within the City. At the end of the year, the fund reported \$61.6 million in fund balance; of that amount \$0.4 million is nonspendable for long-term note receivables leaving \$61.2 million restricted for completion of capital projects. Fund balance for this fund fluctuates from year-to-year based on debt issued and project expenditures; new debt increases fund balance while project expenditures decreases it. For fiscal year 2016 there was an \$18.5 million increase in fund balance as \$18.9 million of bonds were issued to fund capital projects. Analysis of project income and expenditures follows.

Project inflows for the year of \$75.2 million include \$54.9 million in proceeds and bond premiums for new debt and to refinance existing debt. Transfers in of \$17.8 million include \$16.8 million from General Fund, \$1.0 million from Hotel Motel Tax, and \$0.1 million from Community Development. The transfers from General Fund include \$11.9 million planned use of operational dollars and fund balance for pay-as-you-go capital; the remaining dollars were earmarked for economic development and special programs.

Current year project outflows of \$56.6 million include \$10.6 million of economic development projects, \$1.1 million for waterfront improvements, \$7.0 million for street, sidewalk, bridge and tunnel projects, \$1.3 million for ballfields, parks and family centers and \$6.8 million for safety building improvements and equipment. Transfers out of \$1.0 million were to an internal service technology replacement fund and a brownfield grant match.

Proprietary Funds

The City's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. As the City completed the fiscal year its proprietary funds, which include both enterprise funds and an internal service fund, have combined net position of \$760.3 million. Net investment in capital assets is \$607.8 million, with an additional \$48.3 million restricted for future use, leaving \$104.2 million available to meet on-going obligations.



Enterprise Funds - Total net position of the enterprise funds is \$718.8 million, an increase of \$69.4 million or 10.7 percent. Details for each fund are presented below:

- **Electric Power Board** – The largest enterprise fund is EPB, which has both an electric and a fiber optic division. Total net position increased \$32.0 million or 10.6 percent to \$334.2 million, mainly due to an increase in Utility Plant of \$14.4 million. The remainder is a combination of refinancing and repayment of debt. Operating revenues are up \$12.8 million or 1.9 percent. A closer examination reveals that electric sales decreased \$3.9 million or 0.7 percent while fiber optic sales increased by \$15.8 million or 14.8 percent due to the continued success of the residential service offerings. Combined operating expenses, which includes tax equivalents and depreciation, remain even to prior year.
- **Interceptor Sewer System** – Net position of the Interceptor Sewer System increased \$25.3 million or 8.8 percent, to \$311.3 million. Operating revenues rose \$6.7 million or 10.5 percent while operating expenses decreased by \$1.8 million or 3.8 percent. Unrestricted net position (available to finance on-going operations) increased \$37.7 million or 209.9 percent to \$55.6 million. An additional \$34.3 million is restricted for future capital spending, a decrease of \$14.0 million due to less outstanding contract commitments at year end.
- **Solid Waste** – The City of Chattanooga operates a municipal solid waste landfill established to comply with the Environmental Protection Agency (EPA) mandate establishing closure and post closure requirements. The fund has a net position of \$4.7 million. To date the City has accrued liabilities of \$5.4 million for closure and post closure care costs with adequate investments earmarked to cover these costs.
- **Water Quality Management** – The Water Quality Fund, established to comply with EPA guidelines, now has \$67.7 million in net position, an increase of \$6.0 million or 9.8 percent from last year. Net investment in capital is \$26.9 million, leaving the amount available to fund day-to-day operations (unrestricted net position) at \$38.8 million. Unrestricted net position increased 42.4 percent, \$11.6 million.
- **Tennessee Valley Regional Communications System** – The Tennessee Valley Regional Communications System Fund was established in fiscal year 2016 to account for a regional communication system that services a multi-county/multi-state region. The fund has \$1.3 million in net position of which approximately \$1.0 million is restricted for replacement of system infrastructure.
- **Chattanooga Downtown Redevelopment Corporation** – The Chattanooga Downtown Redevelopment Corporation (CDRC) remains in a negative net asset position of \$0.5 million. However, during the fiscal year net position increased \$2.8 million following a continual improvement trend.

Internal Service Fund – The internal service fund is used to account for the City's vehicle operation and maintenance program, employee medical benefits program, technology replacement and third party liability claims. Net position for this fund decreased \$0.4 million or 1.0 percent. This decrease is primarily comprised of \$2.8 million of healthcare costs over premiums and \$2.4 million increase in fleet program reserves for future vehicle purchases.



General Fund Budgetary Highlights

Original Budget Compared to Final Budget

The City's budget ordinance provides for the strategic financial plan of City government, encompassing all major funds and appropriations to agencies. The budget ordinance authorizes the City Finance Officer to make reallocations within the General Fund as necessary.

Final Budget Compared to Actual Results

Revenues exceeded budget for the year by \$14.8 million or 6.2 percent. All revenue categories with the exception of charges for service exceeded expectations. All major revenue categories are addressed below.

- Total tax revenue for the year was higher than budget by \$4.1 million or 2.8 percent. Property taxes, inclusive of payments in lieu of tax, exceeded budget by \$2.4 million or 1.9 percent. The remaining amount is primarily gross receipts tax of \$667,000, liquor taxes of \$408,000 and beer taxes of \$406,000, all exceeding budget estimates.
- Licenses and permits are \$1.5 million or 28.0 percent above budget primarily from building related permits.
- Intergovernmental revenue is \$5.2 million or 6.7 percent more than budget, primarily due to sales tax. Local option sales tax is \$4.2 million or 7.8 percent over budget while state shared sales tax exceeds budget by \$821,000 or 6.5 percent.
- Charges for services are \$863,000 under budget or 17.5 percent primarily from golf revenues being \$184,000 under budget and Metropolitan Medical Response System revenue budgeted but not received.
- Fines and forfeitures are \$1.6 million above estimates. This is primarily due to higher than expected collections for automated traffic enforcement, which was budgeted low pending effects of new state law restricting use.
- Miscellaneous revenue is \$1.7 million or 34.2 percent above budget primarily due to sale of property of \$640,000 and donations of \$704,000.

Expenditures were less than budget by \$9.9 million or 4.6 percent. All departments were under budget. Employee compensation, which is budgeted at 100 percent of budgeted positions, is \$6.3 million below budget due to vacancies. Operations are down by \$3.6 million or 4.4 percent.



Capital Assets and Debt Administration

Capital Assets

At fiscal year end, the City had a \$2.5 billion net investment in capital assets, an increase of \$60.1 million or 2.5 percent. This investment includes land, buildings, utility system improvements, machinery and equipment, park facilities and infrastructure. Net investment in capital assets for governmental funds increased \$14.5 million or 1.0 percent while business-type net investment in capital assets increased by \$45.6 million or 4.7 percent. The following table shows the net investment in capital assets by both governmental activities and business-type activities.

City of Chattanooga's Capital Assets

(net of depreciation, in thousands of dollars)

	Governmental Activities		Business-type Activities		Total	
	2016	2015	2016	2015	2016	2015
Non-depreciable:						
Land & Easements	\$ 1,063,694	\$ 1,045,748	\$ 20,749	\$ 20,517	\$ 1,084,443	\$ 1,066,265
Construction in progress	84,911	77,087	91,471	66,019	\$ 176,382	\$ 143,106
Depreciable:						
Buildings & Improvements	104,574	107,490	81,559	82,628	\$ 186,133	\$ 190,118
Vehicles & Machinery	28,934	25,167	90,008	90,393	\$ 118,942	\$ 115,560
Infrastructure	204,715	216,804	725,901	704,549	\$ 930,616	\$ 921,353
Total	\$ 1,486,828	\$ 1,472,296	\$1,009,686	\$964,106	\$2,496,516	\$ 2,436,402

The majority of capital asset changes are in the construction in progress and infrastructure areas.

- Construction-in-progress (CIP) additions for governmental activities include \$2.7 million for the Family Justice Center, \$2.3 million for paving/sidewalks/road improvements, \$2.1 million for repairs to the Wilcox Tunnel, \$1.4 million for the new Hixson fire station, \$1.2 million for traffic signals and bike lanes, \$1.0 million of waterfront improvements, \$0.6 million in Miller Park District improvements, and \$0.6 million for a Chattanooga Rail Implementation Study. \$6.4 million of CIP projects were capitalized for governmental activities. Construction of projects related to the sewer system's consent decree comprised the majority of the increase in business-type activities.
- The infrastructure decrease in governmental activities is primarily due to depreciation of roads, \$23.5 million which offset the \$9.6 million of CIP infrastructure that was capitalized. Business-type activities infrastructure assets increased primarily from a \$20.4 million addition to the electric distribution system and \$17.0 million increase in the fiber optic customer premises wiring which is offset by a \$7.1 million decrease in customer premises equipment and a \$2.3 million decrease in cable and wire facilities. The net increase was partially offset by depreciation.
- The City of Chattanooga has opted to use depreciation rather than the maintenance method to report infrastructure assets. During the current fiscal year governmental activities recognized depreciation expense of \$38.7 million while business-type activities recognized depreciation expense of \$69.0 million.

More detailed information about the City's capital assets is presented in the Note 5 to the financial statements.

Debt Administration

At June 30 the City had \$718.7 million in long-term debt outstanding. This is a \$50.4 million increase or 7.5 percent, from last year. Detail is provided in the table and narrative that follows.

The City of Chattanooga maintains a "AAA" rating from Standard & Poor's and "AA+" from Fitch Inc. for general obligation debt. The City Charter limits the amount of net general obligation debt to 10 percent of the assessed value of all taxable property within its corporate limits. The City's general obligation debt, net of self-supporting debt, is \$174.6 million; this is 34.2 percent of its current limit of \$511.1 million. As of year-end, EPB had \$276.1 million in revenue bond debt outstanding compared to \$263.9 million last year; these bonds are rated "AA+" by Standard & Poor's and Fitch. CDRC had \$100.9 million in revenue bonds outstanding compared to \$105.6 million last year; these bonds are rated "AA" by Standard & Poor's and Fitch.

City of Chattanooga's Long-term Debt (in thousands)

	Governmental Activities		Business-type Activities		Total	
	2016	2015	2016	2015	2016	2015
General obligation bonds (backed by the City)	\$ 189,225	\$ 174,575	\$ 36,935	\$ 35,275	\$ 226,160	\$ 209,850
Revenue bonds (backed by specific revenues)	-	-	377,000	369,545	377,000	369,545
Notes payable and other	22,937	26,990	92,505	61,742	115,442	88,732
Capital leases	113	174	-	-	113	174
Total	\$ 212,275	\$ 201,739	\$ 506,440	\$ 466,562	\$ 718,715	\$ 668,301

During the year the City issued the following new debt:

- The City issued \$36.3 million in new general obligation bonds. \$28.2 million were related to governmental activities while \$8.1 million were related to business-type activities.
- The City issued \$19.0 million in general obligation bonds to refund \$19.5 million, all were related to governmental activities.
- EPB issued \$41.2 million in new revenue bonds in addition to \$218.9 million in revenue bonds to refund \$239.9 million.
- The Interceptor Sewer System drew down \$33.8 million from a state revolving fund loan for consent decree projects.
- A total of \$39.4 million in debt was retired during the fiscal year; \$32.2 million in bond principal payments were made with an additional \$7.1 million in note repayments.



More detailed information about the City's long-term liabilities is presented in Note 6 to the financial statements.

Economic Factors and Next Year's Budgets and Rates

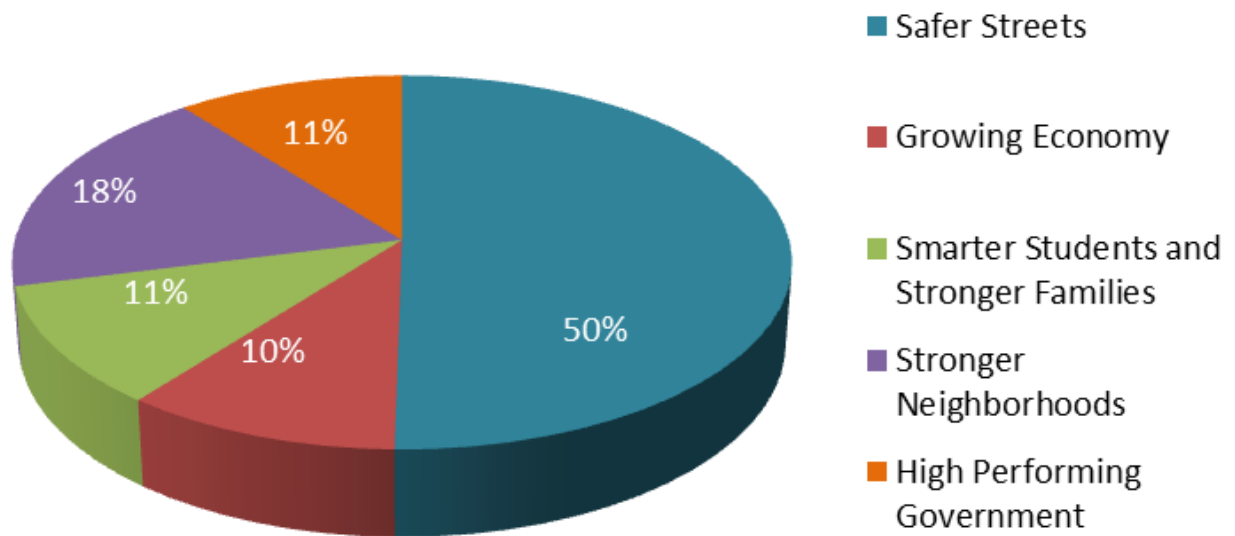
The following factors were taken into account when adopting the budget for 2017:

- Anticipated revenues in the General Fund are \$250.2 million, up \$10.2 million or 4.3 percent from the 2016 budget. The City conservatively forecasts property tax at 95 percent of the tax levy. The fiscal year 2017 budget includes no increase in the property tax rate yet provides sufficient revenue to fund the priorities of residents and meet the City's financial obligations.
- Major revenue increases include property tax revenue of \$3.0 million or 2.3 percent, local sales taxes \$0.5 million or 3.8 percent, and additional local sales tax designated for economic development \$0.5 million or 12.0 percent.
- Expenditures of \$247.4 million reflect an elevated awareness of constituent priorities in the following areas: safer streets; growing the local economy; smarter students and stronger families; stronger neighborhoods; and a high performing government. Expenditures are expected to be \$2.3 million or 0.9 percent more in 2017, primarily because \$2.5 million increase to police or 4.1 percent.
- The City of Chattanooga uses the Budgeting for Outcomes (BFO) approach to establish the annual financial plan for undesignated general funds (\$230,275,000). This approach is based on collaboration, transparency and delivery of services that matter most to citizens. Requests in the form of offers are prioritized by results areas and funded as revenue permits.
 - The 2017 budget funds 34 offers totaling \$115,496,925 (50.3 percent) of the budget for safer streets. This continues funding for 486 police officers, an all-time high, to implement a community-based policing model. Also included is funding for the pay plan for sworn personnel, maintaining a full-time Federal prosecutor, and funding for a Family Justice Center.
 - 25 offers were funded for a total of \$23,690,300 (10.3 percent) for growing the local economy. These offers which invest in the Innovation District and continue the small business incentives of the prior year, will ensure Chattanoogaans have the skills to compete, while strengthening infrastructure to support business expansion.
 - \$24,133,965 (10.5 percent) of the budget provides funding for 27 offers for smarter students and stronger families. These dollars will support children from cradle to career, providing character education, and creating effective programming for parents and seniors.



- Stronger neighborhoods received \$42,079,222 (18.3 percent) to fund 24 offers. This will provide opportunities for every citizen to live in a thriving neighborhood with recreation opportunities and access to variety of transportation options.
- Effective use of every tax dollar is ensured by funding 25 offers totaling \$24,361,406 (10.6 percent) for high performing government. These offers focus on long-term financial health of the City and providing customer service.

Funding of Results Areas



Requests for Information

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances and to show the City's accountability for the assets it receives. If you have questions about this report or need additional financial information, contact:

City of Chattanooga Finance Department

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www.chattanooga.gov

Complete financial statements of the component units may be obtained from:

Chattanooga Metropolitan Airport Authority

1001 Airport Road, Suite 14
Chattanooga, TN 37421
(423) 855-2202
www.chattairport.com

CARTA

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